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March 1, 1999

Ms. Magalie Roman Salas, Secretary
Federal Communications Commission
The Portals
445 12th Street, SW, TW-A325
Washington, D.C. 20554

Re: CC Docket Nos. 96-262, 94-1 and RM 9210

Dear Ms. Salas:

In a series of ex parte meetings, the Sprint Corporation has advocated an access reform proposal to reduce interstate access charges to forward looking economic costs. The United States Telephone Association (USTA) urges the Commission to reject Sprint's proposal. Not only would the Sprint proposal undermine the incentives of price cap regulation, the revival of rate of return regulation, which is the underlying premise of the proposal, would be a disastrous step backward for both the Commission and the industry.

In order to reach its objective, the Sprint proposal would maintain the current 6.5 percent productivity factor and set non-traffic sensitive access rates at forward looking economic cost. As USTA pointed out in its comments in 96-262, the current factor is too high. The update of the FCC total factor productivity model reveals that the productivity factor results for 1996 and 1997 are 2.1 percent and 4.1 percent respectively.¹ The supposed upward trend in price cap productivity predicted by the Commission did not materialize and it is now clear that the 1995 productivity result was a short term peak. In fact, the data reveal that future productivity levels will be lower due to the decline in employment levels and the restructuring of access charges.²

The Sprint proposal assumes that access charges must be reduced to forward looking economic cost (FLEC) levels, and proposes to achieve that hypothetical estimate by undertaking cost studies to determine FLEC levels and then targeting price cap reductions to those elements

¹USTA Comments, CC Docket No. 96-262, October 26, 1998 at Attachment D.

²USTA Reply Comments, CC Docket No. 96-262, November 9, 1998 at Attachment D.

furthest away from the hypothetical level. Sprint's assumption is incorrect, and the FCC's acceptance of this proposal will have pernicious public policy consequences for universal service, investment in advanced technology and the growth of facilities based competition.

Competitive markets exert pressure that drive prices toward FLEC on average. However, the existence of a competitive market for access would not mean that all access services for every customer would be priced at FLEC, any more than the heralded competitive market for long distance has yielded long distance rates for all subscribers at or near FLEC. Only the very largest customers willing to commit to large volumes for an extended period of time are granted rates by IXCs that approach some level of FLEC. Rates for smaller volumes quite properly have higher margins. That is the way a competitive market works. Artificially driving access rates to FLEC by regulatory fiat instead of allowing the market for access to determine the appropriate price could drive some competitors out of the access market. In addition, as fully explained in the record of this proceeding, Commission prescription of access prices to TELRIC even with a prescriptive share of common costs will deny ILECs a reasonable opportunity to recover their total costs, both forward looking and historic.³ Consequently, the adoption of Sprint's proposal could result in a taking of property in violation of the Fifth Amendment.

Sprint's reliance on cost studies to determine FLEC will only serve to generate more contentious debate on the appropriate cost model, and would thereby delay the implementation of much needed pricing flexibility reforms, by diverting Commission and industry resources toward the development and review of cost studies. Either the Commission staff would have to expend limited resources to develop a standardized costing methodology, or they would have to spend time reviewing disparate cost studies submitted by ILECs, IXCs and other parties. Moreover, since Sprint rightly insists that ILECs must be given an equitable opportunity to recover all the expenses assigned to the interstate jurisdiction, the studies essentially would do no more than rearrange the effects of Part 69. Further, even if the Commission were to accumulate information on FLEC, it is not possible for a single regulatory agency to simulate all the nuances and

³See, Affidavit of J. Gregory Sidak and Daniel F. Spulber, USTA Comments, January 29, 1997 at Attachment 3; Reply Affidavit of J. Gregory Sidak and Daniel F. Spulber, USTA Reply Comments, February 14, 1997 at Attachment 2; Affidavit of James M. Fischer, Albert P. Halprin, Henry Rivera and Marvin R. Weatherly, Implications of the Separations Legacy for Implementation of the Telecommunications Act of 1996", USTA Comments, January 29, 1997 at Attachment 2; Richard Schmalensee and William E. Taylor, Economic Aspects of Access Reform, USTA Comments, January 29, 1997 at Attachment 1; Richard Schmalensee and William E. Taylor, Economic Aspects of Access Reform: A Reply, USTA Reply Comments, February 14, 1997 at Attachment 3; William E. Taylor, "Access Reform Again: Market-Based Regulation, Pricing Flexibility and the Universal Service Fund", USTA Comments, October 26, 1998 at Attachment A and William E. Taylor, "Productivity and Pricing Flexibility: Reply Comments", USTA Reply Comments, November 9, 1998 at Attachment A.

complexities of a competitive market process. So long as the access market is to remain open to competition, it would be pointless and fruitless to adopt a prescriptive approach such as that proposed by Sprint.

The Commission has already correctly recognized that a market-based approach to access pricing is far superior to a prescriptive approach. In its Order in this docket, the Commission acknowledged that competitive markets are far better than regulatory agencies at allocating resources and services efficiently for the benefit of consumers. The Commission determined, based on its experience in the access market and the record before it, that a market-based approach to reducing interstate access charges will better serve the public interest.

...rates for interstate access services will generally move toward the forward looking cost of providing such services in response to increased competition in local exchange and exchange access markets. In addition, competition will do a better job of determining the true economic cost of providing such services. As competitive entry becomes increasingly possible, IXC's that now purchase interstate switched access services from incumbent LECs will be able to bypass those services where the prices (interstate access charges) do not reflect the economic costs of providing the underlying services. Those IXC's can do this by entering the local markets themselves as local exchange service providers, thereby self-providing interstate access for their new local exchange service customers. They can also seek out competitive providers of comparable services. As customers choose providers other than incumbent LECs as their local providers, interstate access services will come to be priced competitively. Incumbent LECs will have to respond to competitors' offerings with lower-priced access services of their own in order to retain customers that would otherwise switch to competitors' networks, further increasing the effect on competition on overall access charge payments.⁴

The Commission also recognized that competitive markets will fully develop over time. Sprint's request to jump to a prescriptive approach now is unjustified, as Sprint has provided no evidence to show that the market is not developing in the manner contemplated by the Commission. CLECs, many of which began as competitive access providers, are gaining customers in cities across the country. CLECs have been particularly successful in providing special access and private line services that completely bypass the ILEC network. The increasing number of ILEC forbearance petitions provide overwhelming evidence of competition for special access services and dedicated transport for switched access services. In addition, the IXC mergers that have taken place to date, MCI/Worldcom/MFS/Brooks and AT&T/TCI/TCG, will facilitate entry into the local exchange market as well as the self-provisioning of access services.

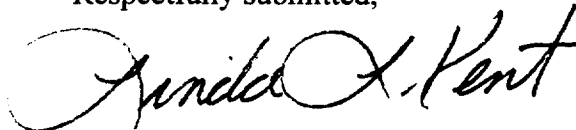
⁴Paragraph 265.

AT&T recently announced a joint venture with Time Warner, the nation's largest cable television provider, to offer local telephone service over cable facilities. This, combined with AT&T's prior acquisition of TCI, will provide the nation's largest long distance company with access to 40 percent of the nation's homes. It was also recently reported that three smaller cable companies, Mediaone Group, Comcast and Cox, are talking with AT&T about local phone service ventures. These three cable companies have over 13.1 million subscribers.

The IXC's are clearly seeking to further their competitive advantage by maintaining regulatory restrictions on incumbent LECs. The Sprint proposal will require the Commission to take on new regulatory obligations at a time when it should be eliminating those responsibilities and encouraging market forces to direct the provision and pricing of services. What is needed is a flexible regulatory structure that allows the pricing of access to adapt to the evolving competitive market. USTA has been working with the Commission staff to develop such a structure and will continue to do so. In addition, the Commission should adopt USTA's universal service proposal to replace implicit support with explicit funding. USTA's proposal would result in a reduction in access charges. The Sprint proposal should be rejected.

In accordance with Section 1.1206(a)(1) of the FCC's rules, two copies of this notice for each of the above-referenced dockets are being submitted today for inclusion in the record of each referenced proceeding. Please contact me if you have questions

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Linda L. Kent", with a large, stylized initial "L".

Linda L. Kent
Associate General Counsel

cc: Tom Power
Linda Kinney
Kyle Dixon
Kevin Martin
Paul Gallant
Larry Strickling
Jane Jackson
Tamara Priess
Rich Lerner
Jay Atkinson
Rich Cameron
Bill Rogerson
Pat DeGraba